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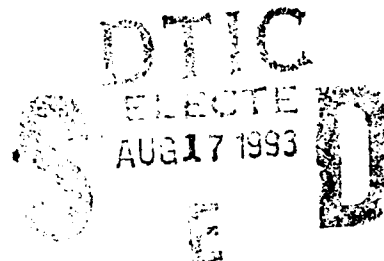
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Comments Relating to Reauthorization of
The Defense Production Act

Statement of
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Before the
Committee on Banking, Housing, and Urban Affairs
United States Senate

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SUMMARY

Mr. Chairman and Members of the Committee:

We appreciate this opportunity to appear before the Committee today to discuss Senate Bill S. 1379 to reauthorize and amend the Defense Production Act of 1950 (DPA).

In recent years the United States has moved to a more interdependent approach in procuring parts and components for its major weapon systems. It is apparent that national security is increasingly tied to the strength of the nation's economy and the ability of industry to compete, particularly in areas where technology leadership is important.

We agree with the emphasis that S. 1379 places on a healthy industrial and technological base. We also generally agree with the thrust of several provisions in S. 1379 that seek to modernize the Defense Production Act of 1950 by providing or authorizing mechanisms or tools to enhance the competitiveness of defense industries. In particular, we support those provisions that seek to (1) foster development of technologies and advanced processes by providing protection from the antitrust provisions inhibiting joint undertakings, (2) encourage contractors to invest in modern equipment to increase productivity, (3) improve the integration of national security and economic policy, and (4) ensure a realistic assessment of the demands placed on industry by national defense plans.

In addition, we have some observations for your consideration. DPA requires an annual report to the Congress on the impact of offsets on U.S. defense preparedness, industrial competitiveness, employment, and trade. We believe that S. 1379 should be changed to better provide for disclosure of significant dissenting agency views in the report. Such views have not been disclosed in the past. S. 1379 currently does not propose this change.

We have two concerns regarding the DPA fund that S. 1379 would create. First, acquiring the initial \$200 million for the fund from the national stockpile could have a detrimental effect on the stockpile program. Second, S. 1379 would authorize stockpiling components and subassemblies in sufficient quantities to meet mobilization needs; but rapid technological developments increase the risk that inventories of such goods could become obsolete.

Finally, we would like to emphasize that effective implementation of DPA requires systematic information gathering and analysis to accurately assess the health of our defense industrial and technology base at all levels, and ensure that critical items and technologies are available. We believe that the Congress should consider the need for adequate information on selected defense industries that support major weapon systems, including critical subtier industries.

Mr. Chairman and Members of the Committee:

We appreciate this opportunity to appear before the Committee today to discuss Senate bill S. 1379 to reauthorize and amend the Defense Production Act of 1950.

In recent years the United States has moved to a more interdependent approach in procuring parts and components for its major weapon systems. Today, many nations have increased their participation in the development and production of these systems. It is apparent that U.S. national security is increasingly tied to the strength of the nation's economy and the ability of industry to compete, particularly in areas where technological leadership is important. We agree with the emphasis that S. 1379 places on a healthy industrial and technological base. The health of the industrial and technological base contributes to the technological superiority of our defense equipment - a cornerstone of our defense national strategy.

In general, we agree with the thrust of several provisions in S. 1379 that seek to modernize the Defense Production Act of 1950 by providing or authorizing mechanisms or tools to enhance the competitiveness of defense industries.

We support provisions that seek to:

- foster development of technologies and advanced processes by providing protection from the antitrust provisions inhibiting joint undertakings;
- encourage contractors to invest in modern production systems and equipment that increase productivity and reduce costs;
- improve the integration of national security and national economic policy; and

-- ensure a realistic assessment of the demands placed on industry by national defense plans.

We have some observations for your consideration regarding provisions that (1) require the President to submit an annual report to the Congress on the impact of offsets on defense preparedness, competitiveness, trade and employment; and (2) establish a revolving fund for purposes such as purchase commitment programs.

Finally, we would like to emphasize that effective implementation of the Defense Production Act requires systematic information gathering and analysis to accurately assess the health of our defense industrial and technology base at all levels, and ensure that critical items and capabilities are available. We believe that the Congress should consider the need for obtaining adequate information on selected key industries that support major weapon systems.

SELECTED PROVISIONS WE SUPPORT

Industry Consortia

S. 1379 would extend protection from antitrust provisions to apply to participants in sanctioned industry consortia. Such consortia are arrangements among entities for the purpose of jointly undertaking a specific program of basic research, research and development, production, marketing, or any combination thereof, relating to industrial resources or critical technologies found to be essential to the preservation or enhancement of the industrial or technology base of the United States supporting the national defense.

Consortia participants which may include potential competitors and universities would be allowed to collaborate on technologies for which significant resources or interdisciplinary research are considered essential.

One example of government-industry consortia is the Semiconductor Manufacturing Technology Institute (SEMATECH). It was formed to provide the U.S. semiconductor industry the domestic capability for world leadership in manufacturing.

SEMATECH has been proposed as a model for other consortia. In this regard, we agree with the Congressional Budget Office, which noted in its September 1987 report, The Benefits and Risks of Federal Funding for SEMATECH, that it is appropriate for government to assist a particular firm or industry if such intervention can be justified on the basis of providing public benefits that go beyond the benefits provided to the affected firms.

We believe that the proposed antitrust related changes improve DOD's ability to increase the efficiency, competitiveness, and responsiveness of the defense industrial base by allowing pooling of resources to effectively resolve production problems. These benefits are achieved through the use of cooperative or consolidated use of the skills, technological resources and expertise of for-profit business concerns, not for profit entities, and educational institutions.

Establishing consortia in support of national defense provides public benefits that go beyond those provided to the affected firms; consortia can be one of the mechanisms to facilitate the transfer of high technology research among all industries, civilian and defense.

DOD's current efforts to prepare a national strategy to pursue important technologies should also enhance the effectiveness of these kinds of activity. A planned strategy that will set priorities among different technologies, define areas that need to be funded, those in need of control, as well as areas that need to be fostered, could provide the guidance necessary to focus the government's efforts.

Investment in Advanced Manufacturing Technology and Processes

We have consistently supported the concept in S. 1379 of modifying profit policies to encourage contractors to invest in advanced manufacturing technology, production equipment and manufacturing processes to improve the efficiency and competitiveness of the defense industrial base. For instance, we have supported increased rates of profit to encourage competitiveness through investments to modernize production systems and equipment.

Assessing Industrial Responsiveness Capabilities

S. 1379 provides for the periodic assessment of defense industry's capabilities to carry out defense plans. We support efforts to assess industry's capabilities to respond to defense needs. Essential to these industry performance assessments is DOD's ability to prepare realistic industrial plans. Accurate information including data on lower level tiers of supply is necessary to achieve realistic plans. DOD is currently revising the industrial preparedness planning approach to assess defense industrial capabilities to meet demands. A DOD working group is discussing, among other things, how the services should approach this integrated industrial capabilities assessment not only to address surge and mobilization issues but

also those international issues that may affect competitiveness at all levels of the industrial base. This integrated assessment approach is a step in the right direction.

Integration of National
Security Policy and
National Economic Policy

S. 1379 supports greater integration of national economic policies and national security policies. We support such efforts which should improve the U.S. ability to maintain a healthy and competitive industrial base. For example, this could help to negotiate and achieve the best terms possible for international agreements.

We not only support DOD's inclusion in policy making discussions of broad economic issues that have an impact on the defense industrial base but also support increasing the role of Commerce in assessing the impact of international defense programs, such as military coproduction efforts, on the overall U.S. industrial competitiveness.

For instance, in our review of the FS-X program¹ we noted that during preliminary FS-X discussions, DOD separated trade and economic issues from national security issues and did not coordinate with or pursue the views of Commerce. In our FS-X review, we supported agency efforts to establish procedures to ensure coordination and consultation in analyzing the benefits and disadvantages of future programs.

¹GAO/NSIAD-90-77BR; U.S. Japan Codevelopment: Review of the FS-X Program.

OBSERVATIONS FOR YOUR CONSIDERATION

Annual Report on Impact of Offsets

The Defense Production Act requires the President to submit to certain Committees of the House and Senate a detailed annual report on the impact of offsets on defense preparedness, industrial competitiveness, employment, and trade of the United States. OMB chairs a coordinating committee composed of selected federal organizations, which prepares the report.

The Act currently provides a formal mechanism for reflecting in the report, differences or dissenting views among the agencies on the interagency committee. That is, the Defense Production Act requires that the annual report provide a summary of the findings and conclusions and include differing views of the agencies that participated in the interagency study. However, OMB officials said that (1) including differing views in the report requires a separate study, (2) no such studies had been prepared, and (3) as a result, dissenting views have not been included in the offsets reports.

Under S. 1379, the Department of Commerce would have the responsibility of preparing the report and submitting it to the Congress. In so doing, Commerce must consult with the Secretaries of Defense, the Treasury, and State, and the United States Trade Representative. Each report would be based on interagency studies concerning the cumulative effects of offset agreements on domestic defense productive capability and the domestic defense technology base.

S. 1379 would provide that alternative findings or recommendations may be included in the report if the Secretary of Commerce has been given, during preparation of the report, an independent study or analysis on which such views are based.

We believe that S. 1379's proposed amendments to section 309 of Defense Production Act should be changed to better provide for the disclosure of significant dissenting agency views. That is, agencies who participated or consulted in the development of the report should not be required to perform additional studies or analyses to have their significant dissenting views included in the report. In the past, such views have not been provided and agency differences regarding study methodologies and assumptions that may have significantly affected the report's conclusions have not been included.

Shortly, we will release a report on our evaluation of the 1988 Offsets in Military Exports report. Our report includes information on the interagency process used for preparing the offsets report and, as discussed above, the need for the Defense Production Act to better provide for disclosure of significant dissenting agency views in the report. Our report also states that the methodology used to prepare sections of the report allowed an assessment of the overall impact of offsets on certain industries. However, such an aggregated analysis did not allow the identification of the impact on particular suppliers or segments more narrowly defined.

The Defense Production Act Fund

Although we support the need to enhance the title III programs, we have several observations regarding the Defense Production Act Fund. For example, the national stockpile planning approach is being modernized to meet the current and future military needs. Stockpile managers are concerned that acquiring the initial \$200 million from the national stockpile could have a detrimental impact on their program. Another concern is the potential obsolescence of stockpiled material. S. 1379, provides authority to stockpile not only critical commodities, but also components

and subassemblies in sufficient quantities to meet mobilization needs. Rapid technology developments could make such goods obsolete. On numerous occasions, we have expressed concern regarding excess items which the government has purchased and stored only to discover that they are no longer useful. Thus, managers of any program of this nature must be very selective in the components that are included. In order for managers to be selective, accurate information on defense needs regarding components of manufacturing for which we are foreign dependent is necessary.

NEED FOR ACCURATE INFORMATION ON FOREIGN DEPENDENCY

We believe the Committee may want to consider a few other matters for inclusion in the Defense Production Act. A tool basic to our Nation's ability to accurately assess the health of our defense industrial and technology base and ensure that critical capabilities are accessible is adequate information on selected defense industries that support major weapon systems, including critical subtier industries.

In recent years, a number of studies have surfaced an increasing concern about a growing dependence on foreign sources for materials and components for our weapon systems. Although evidence of DOD's foreign dependence for critical items in certain weapon systems exists, it is not possible to measure the overall impact or extent of dependence because DOD has no reliable system to identify foreign dependence in parts, components, and technologies essential to defense production.

DOD's current ad hoc approach to defense industrial base data collection and analysis can only provide information on general industry sectors and foreign dependencies through special studies. We believe this ad hoc approach is inefficient and of limited effectiveness for several reasons. First, it provides

only limited visibility into foreign dependencies at lower subcontracting levels, even though, according to DOD, these levels are a major source of technology development in the United States and where we face a significant decline in industrial competitiveness. Second, the ad hoc approach does not facilitate the identification of acquisition strategies that could put DOD in a proactive position to know which domestic sources need to be maintained for particular items and know to most prudently exercise its authority to award contracts noncompetitively when necessary to maintain domestic production sources. Third, the ad hoc approach does not shorten DOD's decisionmaking process for acquiring weapon systems, subsystems, and components by facilitating market research as a more systematic approach would. Systematically obtaining information would improve DOD's ability to identify potential sources for important items and technologies. DOD officials stated that reliance on ad hoc data collection using varying methodologies, puts DOD in a reactive role and limits its ability to identify trends in critical industrial sectors.

In general, we believe that an improved approach to defense industrial base data collection and coordination especially at the subcontractor levels of production is necessary for DOD to properly plan and be in a position to take appropriate action regarding the industrial base including the economic, trade, and technology security implications of procuring items and components of major weapon systems from foreign sources. An improved approach to data collection and coordination would also enhance DOD's ability to make prudent decisions about the National Defense Stockpile and offset agreements with foreign countries that may adversely impact the defense industrial base. Our report Industrial Base: Adequacy of Official Information on the U.S. Defense Industrial Base, (GAO/NSIAD-90-48) addresses this issue in detail.

Mr. Chairman, this concludes my statement. Attached are the responses to the questions you specifically requested that we address. I will be happy to respond to any additional questions you or the other members of the Committee may have.

RESPONSES TO COMMITTEE QUESTIONS

The committee requested that we address the following three questions:

Question 1: Do you believe that current systems for gathering and assessing data on the extent of foreign dependencies among prime contractors and subcontractors of defense materials are adequate? What changes in our current assessment policies and practices would you recommend, if any?

GAO Response: No, DOD has no reliable system to identify foreign dependencies in parts, components, and technologies essential to defense production. Some efforts underway are intended to systematically collect and analyze industrial base data, including the extent of foreign dependencies.

These efforts have been slow in developing, and we believe that more emphasis and resources should be given to put in place a fully operational integrated system. There may also be

a need to clarify DOD's authority to obtain data from contractors and subcontractors that is critical to accurately assess the defense industrial base capabilities.

Question 2: Do you have concerns that foreign companies might become the sole source of certain equipment or technologies vital to our national security?

GAO Response: Yes, we do. While recognizing that the U.S. defense industrial base exists within the context of an increasingly globalized economy in which nations are interdependent and expectations to rely exclusively on U.S. production capability are not realistic, the continuing availability of necessary items and technology is crucial to national defense needs.

Although, we must accept foreign sources as a way of obtaining, in some instances, the best product at the best price, it is important that we monitor this trend closely. Currently there is no systematic or integrated method for assessing import dependency for items and technology critical to national security. Moreover, the military services do not have an integrated system

to assess the ability of the defense industry to supply its needs for future conflict situations.

Question 3: Do you believe the federal government should make greater efforts to foster their development of domestic-based defense-related technologies either directly, through funding programs, or indirectly through encouraging joint industry cooperation or compulsory licensing of foreign technologies?

GAO Response: Yes, we believe that the federal government should make efforts to keep key defense-related manufacturing and development in the United States. This requires identification of key defense-related industries and technologies and accurate information to assess their health to decide which are in most need of government attention.

Question 4: Do you believe that current mechanisms to facilitate the transfer of high technology defense research into benefiting civilian related technologies are adequate? What policy changes, if any, would you recommend?

GAO response: Although we have not performed evaluations on this issue, and cannot comment on whether current mechanisms are adequate, we understand that there are some initiatives underway. For example, an industry consortium is being formed to share unclassified military research developed by the Air Force. In addition, the Office of Technology Assessment is in the early stages of a study which will address this issue.